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TAGS: [EPET](#) [ENRG](#) [SENV](#) [EINV](#) [IZ](#)
SUBJECT: SHELL-SOUTH GAS JOINT VENTURE -- ENDING NATURAL
GAS FLARING IN THE SOUTH

REF: A. BAGHDAD 3002
[1](#)B. BAGHDAD 2891

Classified By: Economic Counselor Michael Dodman, reasons 1.4(b,d)

[1](#)1. (SBU) SUMMARY: The headline-grabbing signing ceremony on September 22 between Royal Dutch Shell and the Ministry of Oil only finalized a Heads of Agreement that must be followed within a year or so by a joint venture agreement between Shell and the South Gas Company to gather and market associated natural gas currently being flared at Iraq's southern oil fields. If and when the joint venture is under way, however, 700 million cubic feet of natural gas per day will no longer burn and pollute the atmosphere, but will instead be a potential source of fuel for a theoretical 3,500 MW of power. Shell, however, will also want to export some portion of the gas, for the higher revenue and possibly to support its other projects in the region. The Shell project will not start from scratch, since natural gas collection and processing facilities are in place, although idled in many cases. Shell appears intent on bringing a liquefied natural gas facility to Iraq to export natural gas. END SUMMARY

[1](#)2. (U) Major newspapers and wire services covered a September 22 signing ceremony of an agreement in which Royal Dutch Shell committed to a project to capture and market natural gas now being flared from major oil fields in the south of Iraq. The reporting focused on Shell's decision to open a Baghdad office, Shell's return to Iraq after a 36-year absence, and its role as one of the original partners in the Iraq Petroleum Company (IPC), which pioneered and developed Iraq's oil fields. The articles noted that 700 million cubic feet of gas, or the energy equivalent of 130,000 barrels of oil, was being burned daily. The Wall Street Journal noted that the project would eventually deliver gas to Iraq's domestic market, mainly for electricity generation, but later would seek to export it, possibly as liquefied natural gas (LNG); the New York Times story quoted Oil Minister Shahrستاني as saying the gas would also be sent to petrochemical and fertilizer plants.

Shell's Perspective

[1](#)3. (SBU) Just prior to the signing ceremony, Shell Executive Director for Gas and Power Linda Cook briefed EMIN Ambassador Marc Wall during a courtesy call that included Shell Gas and Power Vice President Mounir Bouaziz and Shell Exploration and Production Iraq Logistics Manager Ayman Al-Shukr (both based in Dubai). Cook emphasized that the Heads of Agreement to be signed was only the initial step and provided just a general framework for a more detailed agreement forming a joint venture between Shell and the South Gas Company. (Note: Initial press stories incorrectly reported that the joint

venture would be between Shell and South Oil Company.) Shell representatives still needed to visit oil fields to evaluate the condition of natural gas gathering and processing facilities and negotiate detailed terms and conditions for the actual joint venture agreement. Once the agreement was signed, the joint venture would immediately take possession of the existing gas facilities, have responsibility for the associated gas, and become the employer of South Gas Company's 3,000-strong workforce.

¶4. (SBU) Cook said Shell believed the joint venture was consistent with existing legislation, since the deal did not involve production of new gas resources, but was only an agreement to capture and market associated gas. Cook later observed that development of additional oil fields containing associated gas would be essential for the joint venture's future success. Bouaziz noted that an existing Public Company Law allowed state-owned enterprises to form joint ventures with other companies. While Cook and Bouaziz did not want to speculate about the future gas supply or market, they said that emplacement of a floating LNG facility would allow excess gas to be sold that would otherwise need to be flared or require shut-down of oil-producing wells. Bouaziz characterized an LNG production option as a "necessary solution, but not a target." In response to our question, Cook was coy about which of six oil fields and two gas fields for which the Ministry of Oil would request tenders for long-term service contracts would be of most interest to Shell. Her oblique comments, however, suggested that Shell's focus would not be the gas fields.

Terms of the Deal

¶5. (S) Our review of a draft Heads of Agreement, which could differ in details of a final text but not in the broad outline, established that the agreement would expire after a maximum of 20 months, since the parties have 30 days to nominate members to a "Joint Management Committee," the Committee must meet once a month, and the agreement expires 12 months after the Committee's first meeting, but an automatic 6-month extension is also provided. It also awards the joint venture a monopoly to take and market associated gas in southern Iraq for the 25 years of the joint venture, with a possibility of extension. The Heads of Agreement authorizes the joint venture to gather raw gas and commercialize the gas, LPG, and condensate, and deliver it to domestic and export markets. The joint venture will also aim to develop LNG production and export facilities; investigate alternate export routes for dry gas; and develop potential commercial options for sulfur handling. The Heads of Agreement commits the joint venture to purchase and sell gas and gas products at "prices linked to international market prices." South Gas Company, a wholly owned subsidiary of the Ministry of Oil, would have 51% and Shell 49% of the joint venture.

¶6. (S) The Heads of Agreement provides that it shall be governed, interpreted and construed in accordance with the laws of Iraq, but that disputes will be referred to a panel of three arbitrators in Geneva to be resolved according to International Chamber of Commerce rules and in the English language. The Heads of Agreement references Shell's strategic alliance with General Electric "for the benefit of the Joint Venture" and the Parties' intent to develop a similar strategic alliance "with others such as Mitsubishi Corporation." We have also heard separately that the Oil Ministry has required Shell to bring in another international oil company into the project, specifically Chevron.

The Potential

¶7. (U) Widely quoted figures are that Iraq has 110 trillion cubic feet (Tcf) of proven gas reserves and 150 Tcf of probable reserves, although DOE Energy Information Agency suggests that probable reserves could be as high as 275-300 Tcf. Shell will not be starting from scratch with its

project in the south, but will likely begin by renovating parts of the original South Gas/Liquefied Petroleum Gas (LPG) supply system, completed in 1983. Degassing and gas compression/dehydration systems are in place at the North Rumaila, South Rumaila, and Zubair oil fields, with some pipelines feeding into the Khor al-Zubair (KAZ) natural gas liquids (NGL) plant. No gathering system is in place at the West Qurna, Luhais, Majnoon, Nahran Umr, or Misan oil fields.

18. (U) On the North Rumaila field, there is an NGL plant with the capacity to process 350 million standard cubic feet of gas per day (mmscf/d) from five degassing stations, but it currently only takes sweet gas from two of the stations. Sweet gas from two of four degassing stations at the South Rumaila field is also piped to the North Rumaila NGL plant, although pipelines exist to the Khor al-Zubair NGL plant. At the Zubair oil field, five degassing stations would deliver first stage gas to a central treatment plant that is now under commissioning. The treatment plant would remove liquids, compress the gas, and deliver it by pipe to the Khor al-Zubair NGL Plant. The Khor al-Zubair facilities comprise two NGL plants with a capacity of 350 mmscf/d each. One of the plants is currently non-operational due to lack of natural gas. The second plant is totally out of commission. In addition, three liquid petroleum gas (LPG) plants have a capacity to treat 260 tons/hour of broad cut liquids from the NGL plants. Two could be operational, but only one is operating at about 30% capacity. The third LPG train is totally out of commission.

Issues

19. (SBU) A commonly accepted calculation is that the flared gas from southern oil fields could provide 3,500 MW of electricity (ref A). (Note: Iraq now produces about 5,000 MW of power per day with a feasible capacity of about 9,900 MW installed.) Although about 45% of Iraq's power comes from combustion turbines, which operate most optimally on natural gas, the vast majority of the turbines have been modified to run on crude, heavy fuel oil or diesel; some are idled due to a lack of fuel. Operation of the combustion turbines on other than natural gas shortens their life, reduces their maximum output, requires greater down time for maintenance, and triples or quadruples maintenance costs. By some calculations, converting all the combustion turbines to

natural gas would be equivalent to adding 1,500 MW of production to the grid while reducing Iraq's imports of diesel and freeing crude for export.

10. (U) Despite the pressing need and obvious benefits, how much of the Shell project's gas will ultimately be supplied for power generation is unclear. The requirement to provide gas at market-based prices is problematic, since fuel for power is now supplied to the Electricity Ministry at below-market prices. In ref B, Shell representatives did say the project would have the objective of developing and supplying power generation required for oil field and gas processing operations, which would free up power for households and other industrial uses. They also said that half of the gas would be supplied domestically and the other half exported. In addition, of the gas available for the domestic market, some natural gas will likely need to be re-injected to maintain pressure at the oil fields and other gas might go to competing use as feedstock for petrochemical and fertilizer plants.

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